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FINANCIAL DIGEST

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THE PRESIDENT FORECASTS A RECESSION . . .

Administrations are known for optimism in assessing the state of the economy—particularly in an election year—and the Carter Administration is no exception. To be sure, the President, in his annual Economic Report to the Congress, forecasts that the U.S. economy will experience a recession during 1980. This is probably the first time any administration has admitted to the presence of a recession, much less forecast its impending arrival. However, given the state of the U.S. economy today, a good case could be made that a forecast of recession is not a pessimistic view, but rather an optimistic projection.

Recessions bring with them much economic misery, there's no denying that. Sales and output fall, dragging down employment and pushing up unemployment. Corporate profits usually take a header. Uncertainty over the course of events develops. As a byproduct, however, the rate of inflation invariably slows as business finds it more difficult to raise prices and labor becomes more interested in job security and less in winning big wage increases. The slowing of inflation is usually accompanied by declines in interest rates and a rise in the stock market. Eventually, activity turns around and begins to expand, and the economy takes on a healthier glow.

On the other hand, periods of economic activity where the economy does not actually contract, but rather, grows slowly, produce an entirely different set of circumstances. Because the economy is still growing, unemployment does not really shoot up, and employment does not decline substantially. Both may trace a flat path, rising in some months and falling in others. The same might be said for sales and output. This usually produces declines in productivity, thus adding to business cost pressures. The fact that the economy is still expanding enables both business and labor to continue to raise prices and wages, thus the inflation rate does not slow—indeed, it usually worsens. Needless to say, interest rates continue high.

If this latter scenario sounds familiar, it should: It describes what happened in 1979. Last year was generally recognized as a year of a slowdown, with the National Bureau of Economic Research, the umpire of the business cycle, unable to determine as yet whether it was a recession year as well. Since inflation remains our number one economic problem, it is not unreasonable to conclude that, by forecasting a recession for 1980, the Administration hopes to generate enough uncertainty in the minds of business and labor to slow the rate of price increases.

. . . YET, PLANS A TAX INCREASE

The Administration's forecast for 1980 has been characterized in the press as a "mild" recession. However, if it is right, the decline may be anything but mild. Washington forecasts that the real gross national product will average 0.6 per cent less in 1980 than it did in 1979, with a fourth-quarter 1979-fourth-quarter 1980 decline of one per cent. This implies quite a steep decline in economic activity during the first half of this year, perhaps as much as 5½ per cent at annual rates. Such a drop in economic activity, were it to occur, would put this recession more on a par with 1973-75, or at the least, 1957-58, than either the 1970 or the 1960 recessions, both of which were comparatively mild.

In the face of this forecast the Administration is proposing a $40 billion increase in the tax burden borne by individuals and business. Federal tax receipts are projected to rise to 21.7 per cent of the gross national product in fiscal year 1981. This would be the highest percentage that federal receipts take of the GNP since the record 21.9 per cent in fiscal 1944. Personal income taxes are scheduled to average 11.8 per cent of individuals' incomes, also the highest proportion in any year since World War II. Some $14 billion more will be paid by in-

(continued)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures – Millions of Dollars)

	Week Ending 1/30/80	Change Since Week Ago	Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	124,785	—1,391	+14,324
Member Bank Borrowings	1,821	+ 624	+ 394
Float	3,683	—1,644	— 5,788
Total Reserve Bank Credit	135,842	—2,276	+ 9,185
Treasury Deposits with Federal Reserve Banks	3,039	— 34	— 438
Currency Outside Banks	108,753	— 825	+ 9,226
Member Bank Reserves:			
Required	44,386	— 696	+ 2,108
Excess (Deficiency)	375	+ 132	+ 45
Total Reserves Held	44,761	— 564	+ 2,153
Net Borrowed Reserves	1,359	+ 483	+ 376
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	80,799	+ 609	—14,963
		r-Revised	
	1/23/80		
Money Supply ($ Bil., SA) M1	380.3	— 2.9	+6.0%
Money Supply ($ Bil., SA) M2	954.9	— 2.6	+8.6%

NEW YORK MONEY MARKET

Offering Rates 2/1/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.06%	11.93%	11.25%
*Federal Agencies	12.75	13.02	12.15
*Project Notes—Tax Free (46% Taxable Equivalent)	9.72	10.46	10.55
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	13.40	13.52	

‡Finance Company Paper—Prime

5- 14 days	10.00%
15- 29 days	13.15
30- 59 days	13.25
60- 89 days	13.25
90-179 days	13.43
180-270 days	13.45

‡*Bankers' Acceptances

Feb.	13.00%
Mar.	13.10
Apr.	13.95
May	13.92
June	12.90
July	12.80

‡Industrial Paper—Prime

30- 89 days	13.00%
90-120 days	13.00

‖Federal Funds Effective Rate 13.40%

‡Discount Basis. *Subject to Availability. †Estimated.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'79	$ 2,456	$ 2,397	$ 2,235
Gross National Product (1972 Dollars)*	4th Q'79	$ 1,438	$ 1,433	$ 1,427
Percent Change, Annual Rate	4th Q'79	1.4%	3.1%	5.6%
Change in Consumer Prices (all urban consumers)*	Dec. '79	14.4%	12.0%	8.0%
Change in Producer Prices*	Dec. '79	9.6%	15.6%	12.0%
Civilian Employment (Thousands of Persons)†	Jan. '79n	97,804	97,912	96,157
Unemployment as % of Civilian Labor Force†	Jan. '79n	6.2%	5.9%	5.8%
Personal Income*	Dec. '79	$ 2,023	$ 2,000	$ 1,827
Leading Indicators Composite Index (1967=100)†	Dec. '79n	136.8	136.8	143.0
Industrial Production Index (1967=100)†	Dec. '79	152.2	151.8	151.8
Net Change in Consumer Instalment Credit†	Nov. '79	$ 2.41	$ 2.19	$ 3.83
U.S. Merchandise Trade Balance†	Dec. '79n	—$ 3.08	—$ 1.42	—$ 1.75
Plant and Equipment Expenditures*	1st Q'80	$189.32(a)	$179.56	$165.94
Private Housing Starts (Thousands of Units)*	Dec. '79	1,527	1,522	2,074
New Construction Expenditures*	Dec. '79n	$ 239.6	$ 237.4	$ 223.2
Total Business Inventories†	Nov. '79	$ 424.2	$ 421.2	$ 376.8
Total Business Sales†	Nov. '79	$ 299.2	$ 299.1	$ 269.8

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

SHORT TERM PAPER OUTSTANDING

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CDs Weekly Reporting Banks			
Nationwide (1/23/80)	**91,824**	— 581	— 5,919
New York City (1/30/80)	**20,298**	+ 434	— 8,841
Commercial Paper (1/23/80)	**117,425**	+1,951	+31,246

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/23/80)	**156,446**	— 567	+23,869
New York City (1/30/80)	**46,973**	+ 87	+ 8,814

	Total Loans Gross Adjusted Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/23/80)	**393,267**	—4,955	+54,619
New York City (1/30/80)	**88,474**	+ 985	+12,358

SECURITY MARKETS

	Friday 2/1/80	Change Since Week Ago	Change Since Year Ago
U. S. Governments, Closing Bid Prices:			
90-Day Bills (Discount Basis)	**12.16%**	— .14	+ 2.93
180-Day Bills (Discount Basis)	**12.04**	+ .05	+ 2.77
Longest Bills (Discount Basis)	**11.35**	+ .16	+ 2.16
11½s 1/31/82	**99.3**	— 10/32	
10½s 12/31/83	**97.16**	— 23/32	
10¾s 11/15/89	**96.26**	— 9/32	
10½s 2/15/95	**94.5**	—1-17/32	
10⅜s 11/15/09	**92.25**	—1-29/32	
Municipals:			
Bond Buyer—20 Bond Index* (1/31/80)	**7.52%**	+ .19	+ 1.30
Blue List Total ($ Million)	**$ 866**	+$ 36	+$ 95
30-Day Visible Supply ($ Million)	**$1,076**	—$ 212	+$ 22
Total	**$1,942**	—$ 176	+$ 117
Corporates:			
Moody's Aa Composite (1/31/80)	**11.87%**	+ .17	+ 2.44
Money Mgr.—30-Day Supply ($ Million)	**$1,740**	+$ 84	—$ 3
Stocks:			
Dow-Jones Averages			
Industrials	**881.48**	+ 5.37	+ 46.85
Transportation	**283.50**	+ 7.84	+ 70.07
Utilities	**110.32**	+ 2.74	+ 6.06
65 Stocks	**318.85**	+ 5.01	+ 35.70
Standard and Poor's 500 Stocks	**115.12**	+ 1.51	+ 15.62
N.Y.S.E. Composite Index	**66.27**	+ 0.81	+ 10.29
N.Y.S.E. Avg. Daily Vol. for Week (000's)	**54,612**	+ 3,466	+26,862

*46% Taxable Equivalent 13.93%

INTERNATIONAL RATES

	Friday 2/1/80	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	**13.56%**	13.88%
1 month	**13.94**	14.19
3 months	**14.25**	14.50
6 months	**14.25**	14.58
1 year	**13.81**	14.00
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	**12.20%**	12.25%
Long Term (10 to 15 yrs.)	**12.40**	12.50
FOREIGN EXCHANGE SPOT RATES New York Opening (in dollars)		
Belgium	**.03527**	.03553
Canada	**.8652**	.8634
France	**.2445**	.2465
Germany	**.5728**	.5776
Italy	**.001235**	.001240
Japan	**.004158**	.004178
Mexico	**.04380**	.04382
Netherlands	**.5190**	.5232
Switzerland	**.6110**	.6218
U.K.	**2.2705**	2.2780

dividuals in 1981 than in 1980 simply because of inflation. Another $11 billion more will be paid in Social Security taxes next year, while the new crude oil tax may add as much as $14 billion to Washington's coffers.

To be sure, some of this may not come to fruition, since the President has indicated that he will consider tax reductions and temporary spending programs if the economy begins to deteriorate significantly. In this connection, it should be noted that Federal government outlays are already expected to amount to 22.3 per cent of the GNP. This is well above the 21 per cent goal that President Carter once set. Thus no matter how you slice it, the Federal government is going to take a bigger piece of the gross national pie, leaving less for the private sector.

PRODUCTIVITY DECLINES AGAIN

The private sector is having enough trouble making its portion of the economy expand. In the fourth quarter, according to the Labor Department, productivity of business and workers in the private sector declined by an annual rate of 1.6 per cent. This is the fourth consecutive quarterly decline and produced a drop for 1979 as a whole of nearly one per cent. This is only the second full-year decline in 32 years, the other one having occurred in 1974, when productivity fell three per cent. Productivity is the difference between wage increases and price rises, so when it falls, it means that prices are rising faster than wages, thus living standards are declining. Plainly, this, too, was the story of 1979, and it is likely to be repeated in 1980, if productivity falls again, as the Administration apparently expects.

Interestingly, productivity fell in 1979's fourth quarter because paid working hours increased at a faster rate than economic output. Hours worked rose at a 3.5 per cent annual rate in the fourth quarter while output advanced by only 1.8 per cent. What is interesting is that this was the third of the four quarters of 1979 where productivity fell because hours worked rose faster than output. Usually, productiivty falls when output declines and business does not cut hours worked in the same proportion. That business should increase hours worked faster than output in a year such as 1979, when forecasts of recession were widespread, is puzzling.

One possible explanation might be that businessmen felt that, whatever recession would develop would be mild, so there was no reason not to boost payrolls. Another might be the fact that for many companies it has become cheaper to expand output by adding workers, rather than machinery, since labor costs are not climbing as rapidly as the cost of buying, building, and operating new machinery. A third explanation might simply be that the economy is shifting rapidly from those areas where productivity gains are technologically possible, to those where labor intensity is more the rule, rather than the exception. In manufacturing, for example, productivity did better in 1979 than in 1978, rising 1.8 per cent last year as against 0.6 per cent in 1978.

MORE PRESSURES ON THE FINANCIAL MARKETS

Another conclusion that can be derived from the Administration's economic documents is that the financial markets will once more have their job cut out for them insofar as handling fund raising is concerned. For one thing, the deficit in the current fiscal year has been raised from an initial estimate of $29 billion to almost $40 billion. While revenues are now projected to be about $22 billion more for the current fiscal year than was expected a year ago, spending appears to be some $32 billion over Washington's original target. This alone would suggest that the deficit forecast for fiscal year 1981 is not going to be as low as $16 billion. When you consider that further spending increases and/or cuts in revenues may occur if the economy goes into a deep slide and factor in defense spending, which may rise rapidly, you can easily see how the deficit for fiscal year 1981 could easily be double what the Administration is now projecting.

Aside from all this, however, is the fact that the Administration continues to rely on off-budget financing, suggesting that pressures on the credit markets will be even greater than the budget deficit totals indicate—whatever they turn out to be. For example, combining the on- and off-budget deficit for fiscal 1980 produces a financing requirement of over $56 billion. And the $16 billion deficit now forecast for fiscal year 1981 translates into a combined deficit including off-budget financing of $34 billion.

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